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C O N F I D E N T I A L KUALA LUMPUR 001034

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STATE PASS USTR FOR B. WEISEL AND J. JENSEN
COMMERCE FOR 4430/MAC/EAP/BAKER
TREASURY FOR OASIA

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TAGS: [ETRD](#) [EFIN](#) [EINV](#) [MY](#)
SUBJECT: MALAYSIAN GOVERNMENT PROCUREMENT IN THE FTA

REF: A. KUALA LUMPUR 0930

[1](#)B. KUALA LUMPUR 0797

Classified By: Charge' David B. Shear for reasons 1.5 (A & B).

[1](#)1. (C) Summary: Government procurement plays a large role in the Malaysian economy -- valued at an estimated 20% of GDP. The Government of Malaysia has formal procurement rules and officials explain that they are designed to serve a variety of goals, including economic development and the improvement of ethnic Malay economic status. American firms operating in Malaysia complain that implementation of the rules lacks transparency; they suggest that corruption is a significant problem, particularly for larger contracts; and they find "bumiputera" set asides for ethnic Malays restrictive, if not prohibitive. U.S. firms would like to see more discipline in the process so that procurement goes to tender through a definable, systematic and fair system. They also would like greater market access, perhaps through a phase out of bumiputera preferences over an agreed timeframe. Finally, they want a mechanism that would allow them to submit questions and complaints about tender awards and have them answered in a timely fashion.

[1](#)2. (C) Phasing out bumiputera preferences may not be feasible, but even achieving transparent, rules based procurement would make a big difference to U.S. firms. Linking our goals to international "best practices" may make them more acceptable to Malaysian officials. We also can point to Prime Minister Abdullah's public statements about the importance of improving public service delivery and defeating corruption as support for our position. End Summary.

GOM Procurement - The Theory

[1](#)3. (U) Government of Malaysia (GOM) procurement policies are consistent with the "bumiputera policy" that aims to advance the economic interests of ethnic Malays (REF A). The government frankly acknowledges that it uses tenders and contracts to advance the development of a Malay business community. Malaysian bidders are extended a preference that varies with the contract size, and bumiputera firms enjoy an additional preference factor. For example, the Ministry of Defense's general guidelines state that all tenders under RM 100,000 (\$27,778) will be reserved for bumiputera companies. International tenders will be offered only if the goods and services are not available locally. Each ministry prepares the contract specifications and tender documents and advertises for bids. For international tenders, bidders have at least 56 days to submit bids and must furnish a tender

deposit (195 days for defense tenders). Bids are evaluated on technical and financial grounds. The agency's tender board or the Ministry of Finance awards the contract. The American Malaysian Chamber of Commerce (AMCHAM) estimates that government tenders accounted for about 20% of Malaysia's GDP in 2004.

¶4. (U) A ministry may directly purchase from known suppliers when procuring goods, services or works under RM 50,000 (\$13,889). For purchases of RM 50,000 (\$13,889) to RM 200,000 (\$55,556), a ministry must solicit quotations from at least five suppliers or contractors, each of whom must be registered with the government. Companies must register with the Government Procurement Management Division at the Ministry of Finance and there is now a system of e-registration. Procurement of goods, services and works above the value of RM 200,000 (\$55,556) must be considered and awarded by Tender Boards established at each federal ministry. However, goods and services tenders over RM 30 million (\$8.3 million) and works tenders over RM 50 million (\$13.9 million) must be referred to the Ministry of Finance. Its Government Procurement Management Division procures common-use items (e.g. office equipment and supplies, furniture and vehicles) via Federal Central Contracts usually made through open local tenders. Federal and state agencies are required to purchase from these contracts. Government-linked companies (GLCs) are not bound legally by the Government's procurement procedures. In practice, some GLCs allow foreign companies to bid directly, others allow for no foreign competition, and still others seem to require companies to follow the basic Ministry of Finance guidelines.

¶5. (U) GOM rules state that all tenders must be advertised in at least one local newspaper in the Malay language. International tenders must be advertised in one Malay and one English newspaper. Some procurement opportunities can also be accessed through Malaysia's myGovernment website (www.gov.my/MYGOV/BI/MISC/GovernmentTender) or the respective ministries' homepages. There also are a number of private or quasi-private companies that offer websites purporting to list all government tenders. Not all of the ministries advertise their tenders online, nor do all of them do so in English. In any case, many of the tender announcements require the prospective bidder to buy tender documents from the ministry in person, which would only be possible after showing an original Ministry of Finance registration document.

¶6. (U) Malaysia has not signed on to the WTO Government Procurement Agreement (GPA), and has not entered negotiations or sought observer status. It has declined to include government procurement in its bilateral FTA agreements to date. Malaysia's lack of participation in GPA has a negative impact on U.S. companies in Malaysia because they are not allowed to participate in U.S. government procurement. One example is Dell Computers, which maintains a special assembly line in the U.S. for USG sales, since cannot source from its factory in Malaysia.

GOM Procurement - In Practice

¶7. (SBU) In actual practice, many Malaysian government tenders do not follow the government's procurement rules. In fact, even obtaining a copy of the Ministry of Finance circular detailing the rules can be a challenge. (Note: USTR requested a copy of Finance's procurement regulations at the first TIFA discussions with no success. Econoff recently reiterated this request with the same results. End Note.) Malaysia's procurement process falls short in three key areas: lack of transparency, outright corruption, and bumiputera requirements and preferences.

Lack of Transparency

¶8. (SBU) Members of the American-Malaysian Chamber of

Commerce (AMCHAM) would like much greater transparency in how contracts are awarded, and have recommended a model similar to what exists in Singapore (i.e., the Ministry of Finance posts all tenders online, indicates which companies were chosen for the tenders, and the criteria which determined their selection). While many U.S. firms chafe at Malaysia's policy of granting most government tenders to bumiputera firms, they acknowledge this practice is similar to some USG procurement, with certain projects earmarked for bids from qualified small and minority-owned businesses, or with those firms receiving additional "points" in the decision process. AMCHAM's general stance on the issue of bumiputera preferences is that it would like to see them reduced, and eventually removed, over time so this sector will be more open to competition.

¶9. (SBU) However, simply increasing transparency would benefit AMCHAM members. If Malaysia were to clearly indicate which projects are earmarked for qualified bidders from particular groups, foreign bidders could plan accordingly. However, GOM agencies frequently award contracts without having gone through the established bidding process. There also are instances of government agencies being directed to purchase products through designated local or bumiputera firms.

Frequent Favouritism

¶10. (C) In some cases, a prime contractor is selected without a formally announced tender. For example, the Chinese language daily Nanyang Siang Pau recently reported that a project from the Ninth Malaysia Plan (9MP) to develop the South Johor economic region (a contract worth RM 10.2 billion or \$2.8 billion) has been directed to UEM World Berhad, apparently without tender. UEM is owned by Khazanah, the GOM's development arm, and is the largest land owner in the south Johor region. There are widespread rumors that projects from the Ninth Malaysia Plan (9MP) (REF B) are being handed out with no formal tendering process.

¶11. (C) A representative of a U.S. aerospace company complained about the basic unfairness of a system that does not follow a transparent procedure. All too often, tenders never actually get to the bidding stage; an award is simply announced. While his firm has had success in Malaysia, he observed he cannot plan when and where he should spend his resources to compete. There is simply no way to know what is coming and when, especially in the military arena. Malaysia's Ministry of Defense has a published reference book with basic policies and procedures, explaining registration requirements, but does not always follow these procedures. In any case, while his company may deal with different ministries on different tenders, he explained that: "Finance controls it (procurement). Regardless of the rules, they are in control."

¶12. (C) The government programs manager of a U.S. ICT firm complained about a similar lack of transparency in the decision-making process. His firm once made the short-list for a tender with Malaysia Telecom (a government linked company), but lost to another company that did not even bid. While the winning company may have been qualified, Malaysia Telecom never explained its decision or why it had selected a contractor who had not expressed enough interest to participate in the tender process.

A Caveat on Transparency

¶13. (C) The U.S. aerospace executive observed, however, that sometimes U.S. firms have been able to work the system to their advantage. He cautioned that one potential unintended consequence of the FTA negotiations might be an unraveling of various waivers and special arrangements obtained by U.S. companies currently operating in Malaysia. Over time, the GOM has offered different incentives to different companies to attract their investments. Should the FTA negotiations

instill more discipline into the system, some of these preferences could be affected. He also stressed that if old laws stay on the books, the GOM always has the option of simply reinstating them. He noted that the capital controls Malaysia enacted during the 1997 Asian financial crisis were not new, but rather a case of the GOM enforcing laws that it had relaxed.

Corruption

¶14. (C) Corruption is a significant problem, particularly for larger contracts. The U.S. aerospace firm has done fairly well on the commercial side of its business, but has not won a major defense contract in Malaysia in over a decade. The U.S. executive described a variety of defense deals made over this period through shadowy agreements with no tendering process. In one instance, Prime Minister Abdullah's sister-in-law arranged a \$400 million contract to purchase military cargo aircraft from Airbus. The Prime Minister announced the purchase following his return from a visit to France. There had been no indication that the Malaysian military were in the market for a new cargo aircraft prior to this announcement. The U.S. executive asserted that PM Abdullah's brother told him this deal was "done for political or other reasons, such as commission." The executive described similar scenarios for procurement of T91 Polish tanks and SU-30 Russian Aircraft, alleging that the sellers, as well as Malaysian politicians, agents, civil servants and military personnel all received a 30% "commission." Once, someone purporting to work for Deputy Prime Minister Najib approached him about a deal suggesting, "you will get a part of it." He declined this offer.

¶15. (C) The ICT company manager agreed that "there is corruption. Transparency is just a nice word for it." He described how his firm must work through partners who file the tender, saying that he does not always know what is going on with the tendering process. "After all, the Chairman could go to jail if he knows too much," he stated. Malaysian political parties, including the ruling United Malay National Organization (UMNO), rely on "money politics" for much of their operating funds. Projects or tenders often are awarded as political patronage, with a cut of the funds circulating back to the party through different channels.

¶16. (C) Malaysian firms also are targets of corruption. The ICT firm executive related the experience of a cousin, whose firm had bid on a government tender. A ministry tender board informed her that she had won, but instructed her to double the amount of her bid. Concerned about the suggested corruption, she withdrew her bid. Our contact plans to discuss this case with another cousin at the Anti-Corruption Agency, but has no confidence that action will be taken.

Bumiputera Requirements and Preferences

¶17. (C) The U.S. aerospace firm has not found the system of bumiputera procurement to be an impediment and simply works through a Malay middleman. The firm prefers to maintain 100% ownership of its local branch, rather than developing a local partnership that would permit it to bid directly. The U.S. executive would, however, like to see the FTA confirm a commitment to open tendering throughout the GOM and its related GLCs. He is concerned, for example, that Permodalan Nasional Berhad (or PNB, a Malaysian government investment trust), in its capacity as purchasing agent for Malaysian Airlines, will make decisions behind closed doors that could lock his firm out of the commercial aircraft market.

¶18. (C) The government accounts for 30% of the U.S. ICT firm's business in Malaysia. Our contact at the firm believes agencies lack the freedom to select the best contractor due to the bumiputera preferences. Our contact also admitted that his business plan requires partners in some areas and he would not bid on all contracts as a prime. But in areas such as services (consulting, designing, and

maintenance and support, etc), he would like the customer to be able to approach his firm, or for his firm to be able to bid directly on government tenders, so it can bring its best practices to the table. Also, our contact suggested that local companies often are poor project managers. His firm must take on management of many contracts even though it is not the prime. Lamenting his firm's inability to bid directly, he said: "By not being flexible and open to foreign competition, it adds to costs. The prime contractor adds their mark up. Are they giving the best service? Are they giving any service? Sometimes yes and sometimes no."

¶19. (C) A senior manager at another U.S. ICT firm suggested the "rules are restrictive but not prohibitive." He explained that his company does about 30% of its business in Malaysia with the government through various middleman companies or as a subcontractor on larger tenders. He would also bid directly for some projects if the rules allowed. But he cautioned that many U.S. firms would still not want to bid on everything due to the heavy GOM regulations regarding bonding. He said that while he is often comfortable with taking on specific risk as a subcontractor on a portion of a large tender, neither he nor his parent company would necessarily want to take on the bond for the whole tender. Without a significant change in the bonding rules and the requirements for contract completion, this executive would still choose carefully in responding to tenders.

¶20. (SBU) In its FTA submission, AMCHAM reported on a number of other cases that describe the impact of the bumiputera preferences and the lack of transparency in the system. The most egregious and recent of these cases was the October 2005 Ministry of Finance Directive that government agencies may only procure roadway, decorative, and outdoor lighting from three bumiputera companies. Any ministry that does not comply will be penalized and the unauthorized contractors could be blacklisted from future GOM tenders.

¶21. (SBU) The Ministry of Finance took eight months to respond to AMCHAM's request for a meeting to discuss this case. In a May 2006 meeting, Finance Secretary General Sri Izzuddin bin Dali explained the Ministry had reviewed these companies and confirmed their qualifications. He submitted that there would be a new circular posted on ministry's website that more clearly explained the matter and that the number of approved companies would be increased, most likely to six. He did not respond to questions about tendering procedures and why foreign companies were not allowed to bid. He clearly stated that only companies which are majority bumiputera-owned would be qualified to bid.

Government Procurement in the FTA

¶22. (C) The Malaysian government's high sensitivity concerning government procurement is suggested by the repeated efforts of GOM officials to try to remove this subject from the FTA agenda, despite clear statements from USG officials that it must be on the table. The topic also has come under scrutiny in parliament and has been a target of public concern in the press. No other issue has received such intense local attention. Nevertheless, there are tactics with the potential to make this issue more amenable to negotiation.

¶23. (C) Those goals involving transparency, responsiveness and simply getting the GOM to follow its own rules should be easier to tackle, although some Malaysian officials bristle at the suggestion that their system is not transparent. Even though Malaysia is not a party to the GPA, couching our objectives in terms of "international best practices" may make them more acceptable. We also can point to Prime Minister Abdullah's public statements about the importance of improving public service delivery and defeating corruption. Such linkages could be the "sugar" that helps Malaysian negotiators accept the "medicine" of procurement reform.

¶24. (C) As noted REF A, the bumiputera preferences will be the most difficult element of these negotiations. Eliminating them, even with a phase out period, would be an unrealistic objective. A more feasible approach might be to seek a "de minimis" level below which bumiputera preferences would be allowed to remain, but above which contracts would be open to international competition. Even this may be more than the Malaysian government could concede, but merely instilling discipline, transparency and responsiveness in the current system would make a big difference to U.S. firms.
SHEAR